

# NIKKO AM NZ INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

## Market Overview

- The interest rate on the US 10-year Treasury bond fell significantly for a third month in a row.
- Markets were focused on the economic and financial market impact of COVID-19. The impacts have been greater than anticipated as has the Governmental and Central Bank response.
- There have been large price movements in financial markets which have been dysfunctional at times as liquidity has been severely reduced and volatility spiked.
- Central banks and Governments have taken unprecedented actions to try and reduce the negative economic impacts of lock-downs which have been implemented to reduce the spread of the virus and save lives.

## Fund Highlights

- The fund underperformed its benchmark for the quarter.
- The Option Fund posted a significant negative return over the month as bond yields dropped to record lows and the global economic impact of widespread social distancing became more apparent.
- The Corporate Bond fund returns were negative for the month, but remained positive over the quarter as quality bonds fulfilled their role as a safe haven compared to other financial assets.

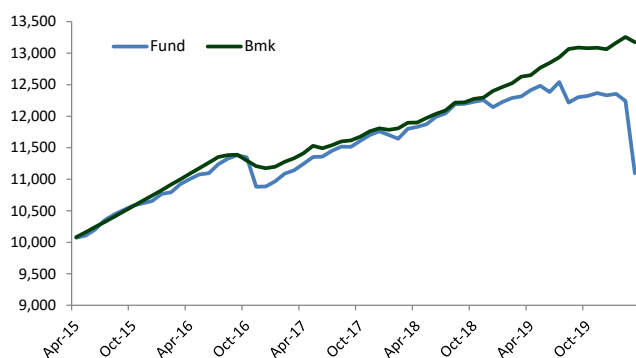
## Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Retail <sup>1</sup>	-9.38%	-10.02%	-9.90%	-0.14%	2.10%	4.55%
Benchmark <sup>2</sup>	-0.61%	0.87%	4.34%	5.15%	5.67%	7.81%

1. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any).

2. Current benchmark: Composite of (from 1 July 2016) of 70% Bloomberg NZBond Credit 0+ Yr Index and 30% Bloomberg NZ Bond Bank Bill Index plus 4%pa. No tax or fees.

## Five Year Cumulative Performance, \$10,000 invested<sup>1,2</sup>



## Portfolio Manager

**Fergus McDonald,**  
**Head of Bonds and Currency**



Fergus is responsible for the investment of the Bond, Cash and Currency mandates. Fergus has been actively involved in the NZ financial markets since 1981. The portfolio management team for the domestic fixed income funds includes Ian Bellew, Fixed Income Manager and Matthew Johnson, Fixed Income Manager.

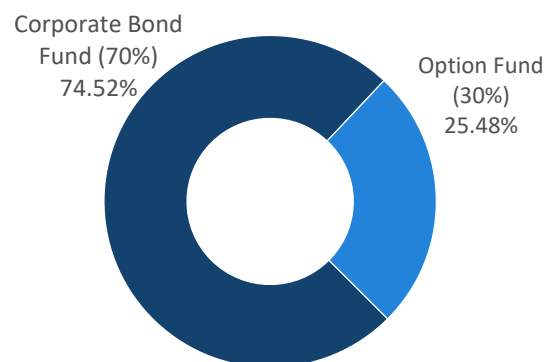
## Overview

The strategy aims to provide investors with regular income from an actively managed investment portfolio while protecting the capital value of investors' funds.

## Objective

From 01 January 2020 the objective of this fund is to outperform the RBNZ Official Cash Rate by 2.50% p.a. over a rolling three year period before fees, expenses and taxes.

## Asset Allocation



Top 5 Issuers*	(%)	Credit Quality*	(%)	Yield – Corporate Bond Fund
US Treasury	30.94	AAA	1.32	Fund (gross) 2.58% vs Benchmark 2.01%
Westpac New Zealand	6.82	AA	71.32	
Kiwibank	6.73	A	25.79	
ASB New Zealand	6.46	BBB	19.88	
NZ Local Govt Fund Agency	6.43	Collateral & options & NR	-20.21	

\*Aggregation of Option and Corporate Bond Funds

## Option Fund Commentary

Initially we saw a ‘flight to safety’ and large scale bond buying as the impact upon economic activity from wide spread quarantining became more apparent. After trading as high as 1.94% in January this year, yields plummeted to an intraday low of 0.31% on the 9th of March. Even in the depths of the Global Financial Crisis (GFC) bond yields didn’t fall to this extent with the previous low point being close to 1.3%, however the excitement wasn’t over with just yet. Within a matter of days yields had climbed back to 1.27% as the prospect of large scale bond issuance from most governments around the globe weighed heavily on investor’s minds. Large government stimulus packages will need to be funded and the first port of call is to issue more bonds. The question of who would buy all these new bonds was answered when central banks embarked on a range of new Quantitative Easing programmes which include large scale bond purchase schemes. From an economic and financial market perspective the enduring impact of the coronavirus will be much higher levels of government debt around the globe and the need to finance this debt for many years ahead. Governments and central banks are now incentivised to keep rates low to help the economic recovery and to keep financing costs manageable. The short term impact on economic activity is almost impossible to quantify. What is known is that growth rates are going to plummet in the second quarter of 2020 before hopefully rebounding by year end but not enough to stop most countries recording negative GDP growth this calendar year. Investors may look through these poor numbers and have their eyes fixed on the strength of the recovery however volatility and uncertainty will be continue for many months ahead.

The fund posted a large negative return over the month as US 10-year US Treasury bond yields dropped significantly as the implications of the coronavirus became more apparent. The large fall in 10-year US Treasury bond yield pushed the fund returns steeply negative over the month as bond yields traded through call option strikes and volatility increased markedly. The speed and magnitude of yield changes in the US 10-year Treasury bond combined with the income received from selling options determines the total return of the fund.

Income levels generated from selling options has increased over the past few months however the income has been swamped by the cost of options being struck. Income levels remain well above its medium term average as a result of greater volatility in Treasury bond interest rates and uncertainty pervading financial markets. This elevated income will over time help restore the value of the fund. If volatility remains elevated for an extended period the income generating potential of the fund looks attractive however the frequency and cost of options being struck will also determine the total return of the fund. Unfortunately, in recent times, the cost of options being struck has far exceeded income received.

## Corporate Bond Fund Commentary

The fund underperformed its benchmark over the quarter. The expansion of credit margins, longer duration positioning, and yield curve positioning were all contributors to underperformance. Credit in general underperformed similar maturities of governments and swap as margins widened significantly. We will continue to focus on maintaining a higher portfolio yield through buying quality non-government bond issues. The credit quality of the fund remains strong. Over the medium term it is likely returns will be supported by a higher yield, and some improvement in credit margins.

### Key Fund Facts

#### Distributions

Retail fund: Calendar quarter

#### Estimated annual fund charges (incl. GST)

Retail fund: 1.07%, refer PDS for more details

#### Hedging

All investments will be in New Zealand dollars

#### Buy / Sell spread:

[Click to view](#)

#### Strategy size

\$4.02m

#### Strategy Launch

October 2007

## Compliance

The fund complied with its investment mandate and trust deed during the month.

## Contact Us

[www.nikkoam.co.nz](http://www.nikkoam.co.nz) | [nzenquiries@nikkoam.com](mailto:nzenquiries@nikkoam.com)

This document is issued by Nikko Asset Management New Zealand Limited (Company No. 606057, FSP No. FSP22562), the investment manager of the Nikko AM NZ Investment Scheme, the Nikko AM NZ Wholesale Investment Scheme and the Nikko AM KiwiSaver Scheme. This information is for the use of researchers, financial advisers and wholesale clients. This material has been prepared without taking into account a potential investor’s objectives, financial situation or needs and is not intended to constitute personal financial advice, and must not be relied on as such. Recipients of this document, who are not wholesale investors (in accordance with Schedule 1, Clause 3 Financial Markets Conduct Act 2013), or their duly appointed agent, should consult an Authorised Financial Adviser and the relevant Product Disclosure Statement. Past performance is not a guarantee of future performance. While we believe the information contained in this presentation is correct at the date of presentation, no warranty of accuracy or reliability is given and no responsibility is accepted for errors or omissions including where provided by a third party. For full details on the retail and KiwiSaver funds, please refer to the relevant Product Disclosure Statement on [nikkoam.co.nz](http://nikkoam.co.nz).